FISCAL NOTE

Bill #:	SB0385	**Title:**	Venture capital fund tax credits
Primary Sponsor:	Mangan, J	**Status:**	As Amended in Senate Committee

Sponsor signature Date   Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
State Special Revenue	$65,000	$65,000
Revenue:		
State Special Revenue	$65,000	$65,000
Net Impact on General Fund Balance:	$0	$0

- ☐ Significant Local Gov. Impact
- ☐ Included in the Executive Budget
- ☐ Dedicated Revenue Form Attached
- ☒ Technical Concerns
- ☒ Significant Long-Term Impacts
- ☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

Department of Commerce

1. SB 385 as amended provides for capital investment funds; provides that capital investment funds must be approved by the Department of Commerce; provides that a capital investment fund must be created for the sole purpose of making investments in primary business sector companies in Montana; requires that a capital investment fund must be a private, for-profit, limited liability company, corporation, or partnership; provides that the size of a capital investment fund must be at least $1 million but not more than $10 million; provides for a 50 percent tax credit for investments in primary business sector companies; provides that 10 percent of the capital investment fund's net return on investment must be deposited in the state general fund; and provides that the net return on investment is excluded from gross income for tax purposes.
2. The Department of Commerce will be required to:
    a. Approve each capital investment fund.
    b. Receive 10 percent of the net return on investment from each capital investment fund for deposit to the general fund.
    c. If investments are made that the Department of Commerce determines do not meet the qualified investment criteria, the Department of Revenue will proportionally reduce and recapture the tax credit.

3. The Department of Commerce estimates that there will be two new capital investment funds created in the first year of the coming biennium and none will be created the second year of the biennium. The fees assessed annually to all funds will provide the $65,000 in revenue in accordance with Section 2(4) of the bill.
4. One professional staff person will be required to administer SB 385, from adoption of rules to quarterly reports and annual reviews required by the bill. Personal services costs are estimated to be $47,700 each year. Operating costs are estimated to be $17,300 each year. If there are not two new capital investment funds created, the hiring will be delayed based on workload.

Department of Revenue

5. This bill authorizes the creation of capital investment funds, which must be for-profit limited liability companies, corporations or partnerships, with capital between $1 million and $10 million. Capital investment funds are to have as their sole purpose investing in businesses that have their headquarters and at least 35 percent of their employees in Montana and that either receive at least 70 percent of their gross revenue from sources outside the state or make 70 percent of their sales to Montana companies that make 70 percent of their sales outside the state.
6. This bill would be codified as part of Title 90, Chapter 8, so that capital investment funds would be limited to investing in business ventures that are new, an expansion of an existing business, or are unable to obtain financing from other sources. In addition, the investment by a capital investment fund may not displace other sources of financing.
7. A capital investment fund would be entitled to tax credits equal to 50 percent of qualifying investments. The documents creating a capital investment fund would specify how credits would be allocated among the owners.
8. For tax years beginning on or after January 1, 2005, the partners in a capital investment fund would be allowed to claim their share of the fund's credits for that year against individual or corporate income tax. The earliest such credits could be claimed would be on returns for tax year 2005, filed during FY 2006.
9. A capital investment fund must pay 10 percent of its net return on investment to the Department of Commerce for deposit in the general fund. Capital investment funds would not make investments until the tax credit is available, in calendar year 2005. Since investments must be in new or expanding business ventures, it is unlikely that any capital investment fund would receive a return from its investments before FY 2006.
10. Net returns on investments made by a capital investment fund would be excluded from taxable income for both individual and corporate income tax. Exclusions of income under this provision would not affect state revenue until FY 2006, at the earliest.
11. This bill would not affect personal or corporate income tax collections before the 2007 biennium, at the earliest.
12. This bill would not have significant administrative impacts on the Department of Revenue.

FISCAL IMPACT:

Department of Commerce

	FY 2004 Difference	FY 2005 Difference
FTE	1.00	1.00
Expenditures:		
Personal Services	$47,700	$47,700
Operating Expenses	17,300	17,300
TOTAL	$65,000	$65,000

Funding of Expenditures:		
State Special Revenue (02)	$65,000	$65,000
Revenues:		
State Special Revenue (02)	$65,000	$65,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
State Special Revenue (02)	0	0

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
None

LONG-RANGE IMPACTS:
Department of Revenue
1. Future impacts on state revenue would depend on total investments made by capital investment funds and the returns on those investments. Based on experience with the existing Montana Capital Company Act, it is likely that at most a few capital investment funds would be formed. If five funds were formed with capital of $10 million each, a total of $25 million in credits could be granted. Since credits would be claimed in the years that capital investment funds made investments and the partners would be required to carry unused credits forward for up to fifteen years, the credits almost certainly would be spread over a number of years.
2. If total investments made by capital investment funds were $50 million and those investment paid a 10 percent rate of return, the state general fund would receive $500 thousand per year during the life of the investments.

TECHNICAL NOTES:
Department of Revenue
1. Subsection 2(2) requires capital investment funds to agree to pay 10 percent of the net return on investment to the Department of Commerce. The Internal Revenue Service may interpret such an agreement as giving the state a partnership interest in the capital investment fund. This would have important federal tax implications for the capital investment fund and its owners.
2. The term net "return on investment" needs further clarification. Is the credit provided by this bill to be taken into account in calculating the net return on investment? How are gains or losses when a capital investment fund sells its interest in a business to be treated in calculating net return on investment? How are gains or losses when one of the owners sells its interest in a capital investment fund to be treated in calculating net return on investment?

DEDICATION OF REVENUE:

a) Are there persons or entities that benefit from this dedicated revenue that do not pay? (please explain) No, fees paid to the Department come directly from the Capital Investment Funds themselves.

b) What special information or other advantages exist as a result of using a state special revenue fund that could not be obtained if the revenue were allocated to the general fund?

A state special revenue account should be established for the allocation proposed in SB 385 because all expenditures and revenues related to the Capital Investment Fund Program would be contained in a single accounting entity.

New Section 2 (4) of SB 385 states:

"THE CAPITAL INVESTMENT FUND SHALL PAY TO THE DEPARTMENT AN ANNUAL FEE OF 0.75% OF INITIAL CAPITALIZATION OR $50,000, WHICHEVER IS LESS, FOR ADMINISTRATION OF [SECTIONS 1 THROUGH 6] AS LONG AS THE TOTAL OF THE FEES, ASSESSED ANNUALLY TO ALL FUNDS, DOES NOT EXCEED $65,000 IN THE AGGREGATE."

c) Is the source of revenue relevant to current use of the funds and adequate to fund the program activity that is intended? __X__Yes ____No (if no, explain)

d) Does the need for this state special revenue provision still exist? _X__Yes ___No (Explain)

A state special revenue account should be established for the allocation proposed in SB 385 because all expenditures and revenues related to the Capital Investment Fund Program would be contained in a single accounting entity.

e) Does the dedicated revenue affect the legislature's ability to scrutinize budgets, control expenditures, or establish priorities for state spending? (Please Explain)

No. While legislatively appropriated, the funds in question are audited by the Office of the Legislative Auditor with any findings being presented to the Legislative Audit Committee.

f) Does the dedicated revenue fulfill a continuing, legislatively recognized need? (Please Explain)

Yes, a state special revenue account should be established for the allocation proposed in SB 385 because all expenditures and revenues related to the Capital Investment Fund Program would be contained in a single accounting entity.

g) How does the dedicated revenue provision result in accounting/auditing efficiencies or inefficiencies in your agency? (Please Explain. Also, if the program/activity were general funded, could you adequately account for the program/activity?)

A state special revenue account should be established for the allocation proposed in SB 385 because all expenditures and revenues related to the Capital Investment Fund Program would be contained in a single accounting entity.